Strategic Acquisition Program Series Part II: Process Matters

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Synopsis: Developing the capability to realize the benefits of proprietary acquisitions is laden with challenges, including the commitment of substantial resources and the strategic alignment across the organization. Bearing that in mind, a reliable and comprehensive framework is invaluable in developing and implementing a state-of-the-art, proactive acquisition program which ensures that resources are adequately managed, and results maximized.

Read on for our views…

The Challenge

How is an Effective Acquisition Program Implemented?

Your organization has resolved to develop the capability to capture the myriad benefits of proprietary acquisitions. Where do you start?

Not all companies can be successful consolidators. Studies have supported the common-sense conclusion that successful acquirers have developed strong core competencies in (a) sourcing, (ii) executing, and (iii) integrating acquisitions. Significant shareholder value can be created by companies that develop competencies in these three areas.

Building the capability to proactively source acquisition targets is a significant undertaking. It requires a significant investment in the right people, a team structure that leverages specialists, customized systems, and specialized skills in managing private business owners. Perhaps most importantly, success requires strategic sponsorship within the organization, including the commitment of senior management, and the Board, to the strategy. A disciplined and well-defined acquisition sourcing program can address the challenge.

How would such a program be designed? To understand the resources required, process architecture should first be determined, and the resources would be marshaled to execute this process.

Process Matters

In our experience, a successful, proactive Strategic Acquisition Program ("SAP") requires significant resources and systems to simultaneously support the required (i) target research, (ii) vendor contact, tracking and follow-up, (iii) management of, and negotiation with, vendors, including document and information flow, (iv) due diligence, and (v) definitive documentation. Most teams can effectively manage just one transaction at a given time. Special capabilities are required to simultaneously manage multiple target discussions at various stages in the process and keep them all moving forward.

There are many ways to execute an SAP and there are no right or wrong answers. The ideal process is one that fits well with (i) the acquisition team's strengths, style, and governance structure, (ii) the size and scope of the target universe, (iii) available resources, and (iv) receptiveness of targets. Typically, adjustments are made based on what is learned through the process. The process outlined below focuses primarily on the unique sourcing and qualifying aspects. This document reflects an evolution of refinements we have observed with leading consolidations, executing many SAP assignments for clients in many industries, and approaching several hundred acquisition targets in North America and Europe.

There are Six Distinct Project Phases:

A. Confirming that Acquisitions Fit the Strategy

B. Pre-Launch Preparations

C. Target Contact and Qualification

D. Acquisition Proposal

E. Due Diligence and Documentation Process

F. Closing

A. Confirming that Acquisitions Fit the Strategy

i. Clarification of Strategic Objectives

- Are acquisitions part of the strategy going forward? If so, in what areas? What is the aim of this strategy?
- What are the acquisition criteria (geography, size, products/services, end markets, distribution channels, etc.)?
- What is the value creation thesis (cut G&A, rationalize capacity, best practices, fill gaps in product/service offering, leverage distribution channels, purchase multiple arbitrage, etc.)?
- How satisfied are you with your current efforts and results?
- Confirmation of strategy and criteria may be iterative, depending on target universe complexity and commitment to the strategy. It can be helpful to walk through a sample target list with the project team and the project sponsors to ensure you are on track and to confirm the thresholds of the criteria.

ii. Confirm Scope of Consolidation Opportunity

- Conditions for a successful SAP must be present:
  - a) Economies of scale;
  - b) Fragmentation with ample targets;
  - c) Cost and/or distribution synergy potential; and
  - d) An industry catalyst, such as customers rationalizing suppliers, regulatory change, or technological change can be helpful.
- Based on the investment criteria, generate a target universe using standard database filters to determine the size of the target universe that would need to be reviewed to confirm the fragmentation thesis.

iii. Confirmation of Financial Capacity, as Required

- It is important that process momentum be maintained by ensuring financing is available in advance.
- This is not an issue for many large public companies and private equity sponsored platforms.
- Consider confirming credit capacity and secure a commitment for a specific amount of capital that senior management is prepared to commit to the initiative.
- If there is a potential issue, discuss a plan to access additional funding if required. Is there an appetite to do that for the right deal?

iv. Confirmation of Valuation Expectations

- It is important to establish that internal expectations of valuation are not significantly lower than the market.

- If there is a significant gap, consider the search costs associated with wasted time and resources.

v. Acquisition Criteria and Screening Parameters Confirmed

- As noted above, it can be helpful to walk through a sample target list with the project sponsors to ensure the project team is on track and to confirm the boundaries of the criteria.

B. Pre-Launch Preparations

i. Initial Target List Provided to Project Sponsors for Approval

- Many lists may be submitted over the course of the project. This is a "batch" rather than a continuous process, where the team can reassess how the process is working, the targets they are seeing, target response, etc. It is a natural break where you can adjust the strategy, including deciding whether or not you wish to continue.
- Lists should be of manageable length, with an ideal range of 10-30 targets.

ii. Determine Which Targets to Pursue

- Review the target list with the project sponsors. There are three potential categories for each target:
  a) **Approach Now**: Only these targets go onto the approved list;
  b) **Not Now, Maybe Later**: Agree on when the team will re-introduce the target for approval and follow up with project sponsors then; and
  c) **No**: These targets are dropped from further consideration.
- This feedback informs your selection of future targets. Working through concrete examples allows the team to challenge the project sponsors and improve internal understanding of acquisition criteria.

iii. Initial Target List Finalized

- Revisions to the proposed list are made and the revised list is submitted to project sponsors for approval.
- No target contact is made until approval is explicitly given by project sponsors.

iv. Approach Letter, Call Scripts, NDAs, Information Request Lists, Follow-Up Protocol, Other Target Correspondence and Assessment Protocol/Tools Approved

- Developing a clear value proposition for the target will maximize the effectiveness of your approach. Articulating your value proposition should be clear in the approach letter and in the initial call with the target.
- The target may be guarded when approached by a competitor. Messaging should be subtle and nuanced. Consider how you can gain an understanding of their objectives, rather than simply saying “we might want to buy you”.
- Approach strategy for a publicly listed target is completely different than a private company approach.
- Approach letters are typically sent by FedEx to the target vendor to ensure it is not treated as junk mail. This maximizes response rates.
- Discuss what will be said on the initial call. Consider a written call script.
- Draft a short NDA to be shared with potential targets.
- Draft a proposed information request list as a means to qualify the target. Sometimes there are specific metrics or business information that are

critical to see prior to committing resources to in-depth due diligence.

- Confirm how you will conduct the phone pursuit of the targets and when the team will assume there is no interest. Typically, it is proposed to initiate phone contact two business days after expected receipt of the approach letter, then two follow-up attempts per week. If no contact established after three phone attempts, send a final close-out letter by regular mail to say you assume the lack of response is an indication of a lack of interest.
- Close-out letter drafted.
- Commit to track those targets that ask you to follow up with them on a more extended time frame, like “not a good time now, call me in the fall”, etc.
- For those targets that submit information, agree what assessment tools will be used, key parameters, and the threshold tests to be applied in qualifying targets.
- Consider drafting a letter of intent (“LOI”) template in advance, to avoid loss of momentum during target dialogue.

v. Approach Strategy and Contact Information Determined for Each Target

- It can require significant time and resources to target the right people and secure their contact information. Often, it requires an inquiry at the general number.
- Avoid sending a letter to an unnamed person if no contact person can be identified. Confer with your sales and operating teams who may have been in contact with the target company on whether they have any ideas and decide how to proceed from there.
- However, for targets already known to your company, ensure you have a list of the key contacts and a history of the discussions with those contacts. Seek input from those who have been in direct contact on the best approach strategy for those targets.

vi. Internal Approval to Launch

- An in-person kick-off meeting is the ideal forum to run through a readiness checklist prior to launch:
  a) Initial target list approved;
  b) Approach documentation and pursuit protocol agreed; and
  c) Other potential issues, such as financing, management team availability to follow up on targets, etc. are addressed prior to launch.

C. Target Contact and Qualification

i. Approach Letters Sent

- Letters are sent to target vendors by FedEx to ensure the letter is respected and read by the target person. Letters are marked “Personal and Confidential” to respect the vendor’s privacy.
- Sent in manageable batches so that they can be followed up on in a timely manner. The whole list would not be sent in one day.
- Contact details for some targets take longer to find than others and it is best not to wait for all of the contact information to start sending approach letters.

ii. Initial Phone Contact

- Typically, two business days are recommended following expected receipt of the approach letter. However, you do not want to call before the person has read the letter.

- Do not leave details on the nature of the call with the reception or assistant. Usually say, “Out of respect for Mr. Smith’s privacy, I cannot discuss that. We have outlined in detail the nature of this call in the letter we sent him [last week]. Do you know if he has received the letter? It was sent by FedEx and it should have arrived there [the day before yesterday]”.

iii. Interest Confirmed

- Attempt to move to verbal qualification if the target will accept a verbal commitment to non-disclosure. Otherwise, move to execute an NDA.

iv. Sign NDA with Target, if Requested

- Make a verbal commitment to confidentiality in any event.

v. Verbal Qualification

- If there is interest in talking, pre-qualify with some very basic information on the phone. For example:
  a) Confirm EBITDA or cash flow for the last fiscal year;
  b) Revenue;
  c) Main products and end markets; and
  d) Ownership.
- If this checks out, proceed with the formal information request.

vi. Information Request List Submitted

- Send to the target the information request list.
- Follow the list up with a phone call to walk through it and determine whether some items will be challenging for them.
- Negotiate how to fill any information gaps.

vii. Information Received and Preliminary Financial Modeling Completed

- Build any models and populate any assessment templates.

viii. Call with Business Leadership and Target

- First opportunity to introduce them and have a basic Q&A on the target’s business.
- Send a call agenda to the target in advance.
- There may be several follow-up calls to enhance understanding.
- Defer site visits until an LOI with basic deal terms is agreed upon.

D. Acquisition Proposal

i. Draft an LOI for Project Sponsor Approval

ii. Send the LOI to the Target

iii. Negotiate and Execute the LOI

E. Due Diligence and Documentation Process

i. Commence Drafting of Definitive Documents

ii. Confirm Vendor Legal Counsel and Recommend Changes, if Preferred

iii. Formulate Due Diligence Plan

iv. Business Due Diligence

v. Financial/Accounting Due Diligence

vi. Legal Due Diligence

vii. Environmental Due Diligence, if Applicable

viii. Other Due Diligence

ix. Provide Draft Agreement to Vendor

x. Business Transition

xi. Negotiate Definitive Agreement

F. Closing

i. Final Approval

ii. Execute Agreements

iii. Activate Integration Plans

Conclusion

Process matters. Developing a process to thoroughly and efficiently identify and screen potential acquisition targets is critical to establishing a plan and determining the internal resources required for success. This plan should involve approaching targets in parallel, engaging them in strategic dialogue, qualifying them, and keeping the process moving forward, ideally for many targets simultaneously, with each moving at their own pace.

Implementing a state-of-the-art process that maximizes results requires significant resources and skill. Developing a well-designed process without committing the resources to execute it will disappoint those who sponsor the initiative. Furthermore, under-resourcing the initiative can result in inferior performance by the resources that have been committed because they have not been given the tools for the job. The challenge is compounded by the financial impact of adding significant fixed expenses for "corporate support", which can be a tough sell to the Board of Directors and to shareholders. Patience and staying power are required during the first 12-18 months as the team ramps up. This includes implementing and refining the program.

Valitas has developed a process that works and has the purpose-built resources to execute it effectively. We do this in a way that is not only complementary to our clients' internal capabilities, but also leverages these resources to make them more productive. The final installment of this three-part series, ***Addressing the Challenge: Surfacing Proprietary Acquisitions***, outlines how Valitas works with its SAP clients to create considerable shareholder value by bringing the considerable resources of our firm to address these resource challenges.

Click here to receive Part III of this series.

About Valitas

Valitas Capital Partners is a relationship-focused merger & acquisition (M&A), corporate finance, and strategic advisory firm. We collaborate with ambitious owners of high-performing businesses with a potential value of at least $100 million, to discover, unleash, and realize their full business value potential.

Owners and their leadership teams rely on Valitas when they:

- Want to triple the value of their business in five years or less, but realize they lack the expertise and experience to achieve this alone.
- Want to sell their company now, assured they will look back after the transaction knowing they got the best possible outcome.
- Seek the peace of mind of taking some chips off the table now, to secure their family's financial future without giving up control or the future increased value in their business.
- Are anguished they had to say no to growth opportunities they worked so hard to create because their bank cannot keep up with the needs of their fast-growing business.
- Are frustrated at the lack of traction they are getting with their acquisition efforts, whether it is not seeing enough quality acquisition opportunities, or by wasting time and money coming up empty-handed in auctions.
- Are dispirited by the significant investments in expensive specialists, technology, systems, and financial modeling capabilities required to execute their audacious strategic goals.
- Are intrigued by the idea of selling their business to their management team over time but want to recognize the full value now, while getting their cash payments as quickly as possible.

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About the Author

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Paris Aden is the founding Partner of Valitas Capital Partners. Since 1994, he has been involved with more than 100 M&A transactions with an aggregate value exceeding $80 billion. He has advised clients at Morgan Stanley, Credit Suisse First Boston and RBC Capital Markets and has acted as a private equity investor at Clairvest Group where he served on portfolio company boards. Paris was also a co-founder of Alluence Capital Advisors, a mid-market M&A advisory boutique that focuses on cross-border transactions.

Paris is recognized as an expert in business strategy, M&A and corporate finance. Previous roles and speaking engagements include:

- Lecturer at the Stephen J.R. Smith School of Business at Queen's University in their Master of Finance (MFIN) program
- M&A subject matter expert for Moody's Analytics' Advanced Capital Markets Program for capital markets professionals
- Three-time expert panel moderator for the Toronto Business Transitions Forum
- TEC Canada "2018 Speaker of the Year" recipient
- Guest speaker for various industry and business leadership organizations

Paris formed Valitas to meet the unanswered needs of ambitious business owners seeking to:

- At least triple their business value in five years or less; or
- Are seeking an elite advisory boutique as their trusted advisor for their complex, mission-critical transactions.